Wesfarmers Limited

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NEWS

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WESFARMERS REPORTS STRONG FIRST HALF RESULT

The directors of Wesfarmers Limited today reported a strong result for the half year ended 31 December 2001, with operating profit increasing 61 per cent over the previous period to $180.3 million. This result is slightly ahead of expectations following the completion of the Howard Smith acquisition in August 2001.

Operating profit before goodwill amortisation was $217.5 million, an increase of 89 per cent over the previous period. The result was achieved on operating revenue of $3.6 billion which was 85 per cent higher than last year's $1.9 billion.

The inclusion, from August, of results from Howard Smith's hardware and industrial and safety businesses was a strong factor in the earnings and revenue growth, as was the achievement by all business segments of first half results which exceeded the comparative period last year.

Included in the 31 December 2001 half year result is profit after tax on the sale of non-current assets of $7.7 million, which compares with $3.3 million earned in the same period last year.

The group's reported earnings per share (before goodwill amortisation) of 63.5 cents for the half year was 46 per cent above the 43.5 cents in the corresponding six months last year. Cash flow per share of 93.3 cents was also higher than last year's 71.6 cents.

Hardware

Operating revenue for the Bunnings hardware merchandising business increased by 118 per cent to $1.5 billion in the first half. Earnings before goodwill amortisation of $146 million were 85 per cent higher than in the corresponding period last year.

The increased revenue and earnings were due to the inclusion of trading results from Howard Smith's BBC Hardware operations acquired in August 2001 and continuing strong growth in the underlying Bunnings business.

The underlying growth is gratifying given the management effort required in the period in regard to the Howard Smith acquisition. Good progress has been made in the integration into Bunnings of the BBC Hardware businesses – Hardwarehouse, BBC and Benchmark. A more detailed progress report on aspects of this integration work is attached.

Increases in retail sales were enjoyed in all regions including Victoria, where unseasonal weather in the second quarter dampened demand. Store on store growth in Bunnings outlets, excluding stores not trading for the full period and excluding stores affected by Bunnings warehouse store openings, was 11.0 per cent. BBC/Hardwarehouse growth, on a comparable basis, was lower at 5.8 per cent although encouragingly, the low growth of the September quarter of 2.5 per cent increased to 8.5 per cent in the December quarter

Gross margins were adversely impacted by several factors, including seasonal product mark-downs in Victoria related to the poor second quarter weather and the clearing of redundant lines and surplus stock in Hardwarehouse and BBC stores.

The growth in trade sector sales was slightly below budget reflecting ongoing insurance industry-related building approval delays. Trade sales represented 23 per cent of total sales in the first half.

The outlook for hardware in the second half is positive. Work to fully integrate the Bunnings and BBC Hardware businesses is ongoing and is now focusing on driving improved performance across the acquired store network.

Energy

Operating revenue of the energy industry segment increased by one per cent to $475 million in the first half. Earnings, before goodwill amortisation, of $107.0 million were 16 per cent higher than the $92.5 million recorded in the same period last year, due to strong growth in coal earnings.

Coal

Sales volumes from the Curragh mine in Queensland were on budget and 17 per cent above last year. Increased selling prices and higher export volumes resulted in earnings that were markedly above last year. The timing of export shipments in the period favoured the first quarter and production was reduced in the second quarter by planned major dragline maintenance works.

The Bengalla coal mine in New South Wales, in which Wesfarmers has a 40 per cent interest, produced sales volumes and revenue above last year but below budget due to increased competition in international steaming coal markets together with weaker demand and prices. Bengalla earnings were also above last year but below budget.

Coal deliveries from the Premier mine in Western Australia were slightly ahead of the corresponding period last year and earnings were in line with last year. An in-principle agreement has recently been reached with Premier's main customer which satisfactorily resolves the coal volume dispute.

Development highlights included satisfactory progress on preliminary works at the Curragh East deposit in preparation for mining commencement in mid 2002. Plans and approvals have also been finalised to complete an upgrade to the Curragh coal preparation plant in the last quarter of this financial year. Senior management positions within Wesfarmers' coal operations have been reorganised to support continuous improvements in all operations and to position the business for further growth.

The outlook for coal in the second half is positive. Export steaming coal sales volumes and prices, which were under pressure in the first half, have stabilised and are now showing signs of a modest recovery. The coking coal market remains firm with positive prospects from annual price and volume renegotiations.

Gas

Domestic LP gas sales volumes and revenue were below last year, with autogas demand in particular weaker than anticipated.

Export sales volumes were also below budget and last year due to a delayed export shipment budgeted for December and plant shutdowns while expansion works were undertaken. The lower volumes and weaker international LP gas prices resulted in earnings below budget and last year.

Growth highlights included the completion of de-bottlenecking work at the recently expanded LP gas plant in Kwinana that has lifted production capacity by a further 10 per cent to at least 330,000 tonnes per annum. Trading from the 55 per cent owned Bangladesh LP gas business commenced in the second quarter after the successful completion of the development phase of this project.

In September, Kleenheat secured a controlling stake in StateWest Power, an independent power producer specialising in electricity supply to mining operations and regional towns. Kleenheat now holds a 73 per cent stake in StateWest Power and this business made a small contribution to earnings in the period.

The overall first half profit contribution from the group's gas activities was below budget and below the comparative period last year. Full year earnings are dependent on both local demand recovery and international price trends, but are expected to remain below budget and last year.

Industrial and safety

Businesses within the industrial and safety industry segment - Blackwoods, Alsafe and NZ Safety - were acquired as part of the Howard Smith takeover. Also included in this segment is the Atkins Carlyle business which was acquired by Blackwoods in May 2001 and the Protector Safety Supply business which was acquired by Alsafe and NZ Safety in July 2001.

In the period from August to December 2001, the industrial and safety businesses reported operating revenue of $485 million and earnings, before goodwill amortisation, of $39 million. These results were consistent with expectations and pleasing in light of difficult trading conditions in the Australian industrial sector over this period.

Post August 2001, the industrial and safety businesses have been drawn together under one management team. This has accelerated a number of business improvement initiatives aimed at leveraging the scale of the combined business operations and improving earnings. Integration work on the Atkins Carlyle and Protector Safety Supply acquisitions is also well advanced with synergy benefits being extracted in line with expectations.

The outlook for the industrial and safety businesses is positive, with improving trading conditions anticipated.

Rural services and insurance

First half operating revenue of the group's rural services and insurance business of $806 million was 90 per cent above the comparative figure of $425 million last year. Earnings, before goodwill amortisation, of $34.6 million were 32 per cent above last year's $26.1 million. The performance uplift is a result of generally positive trading conditions across the underlying activities and contributions from the IAMA business acquired in February 2001.

Merchandise and fertiliser sales rose by 118 per cent, with this result strongly influenced by the IAMA acquisition. Revenue and gross profit increases were achieved in all other underlying activities, with the exception of wool.

The integration of the IAMA business is now largely complete with synergy benefits being realised in line with expectations.

Prospects in the near term for most rural commodities, other than cotton, are reasonable. Subject to seasonal conditions, the outlook for Wesfarmers Landmark is positive.

Premium income for Wesfarmers Federation Insurance grew by 17 per cent in the first half as a result of higher new business levels and retention of existing business at above-budget levels. Despite significantly higher than anticipated crop insurance claims, the business performed to expectations overall. Assuming normal conditions in the second half, Wesfarmers Federation Insurance is expected to record a result in line with budget.

Fertilisers and chemicals

Operating revenue of $156 million from the group's fertilisers and chemicals business for the six months was three per cent lower than for the comparative period last year. Stronger volumes in chemicals resulted in earnings, before goodwill amortisation, increasing by 30 per cent to $9.9 million compared with last year's $7.6 million. Historically, over 70 per cent of fertiliser sales occur in the second half of the financial year. This is reflected in the low absolute level of the first half earnings figures.

Total fertiliser despatches were 29 per cent below those in the corresponding trading period last year, mainly due to a carryover of 1999/2000 seasonal demand into the July and August 2000 comparative trading period. Development work to replace the existing core cropping fertiliser range is close to completion and the new range of products will be launched into the 2002 season.

Stronger than anticipated harvest conditions and commodity prices will place cropping and mixed farming enterprises in a better financial position for the 2002 season than earlier predicted. Wesfarmers CSBP currently estimates that it will sell just over one million tonnes of fertiliser in the full year, an uplift of about 75,000 tonnes from last year. This is, however, around 50,000 tonnes below the original budgeted level.

Overall sales volumes of the company's chemical products were 20 per cent higher than in the corresponding period last year. Ammonia volumes increased by 13 per cent and ammonium nitrate sales increased by 23 per cent. Sales revenues for all chemical activities were above budget.

The Kwinana ammonia plant was shut down for an unplanned 27 days in November following a secondary reformer failure. Prior to and after that event, the plant operated at nameplate capacity. The unplanned shutdown, however, necessitated an import cargo in January, which will adversely impact earnings in the second half.

The development of a solid sodium cyanide plant by the 75 per cent owned Australian Gold Reagents has now commenced, with the plant scheduled to begin operations in the first quarter of 2002/2003. This plant will convert sodium cyanide solution into solid form for sale in international markets, addressing the flat forecast Australian demand for cyanide and increasing utilisation of the existing liquids plant.

Operations at the Queensland ammonium nitrate joint venture were below expectations in the period. Despite good demand, achieving continuous production over prolonged periods remains a challenge.

Full year earnings for chemicals are expected to be above budget and last year.

Other operations

Operating revenue of the forest products business in the first half was above budget but below the level of last year due to divestments. Earnings were also above budget but 20 per cent below last year. The orderly rationalisation of these business activities continues to progress well and earnings for the full year, although expected to be above budget, will be below last year.

Revenues from the 50 per cent owned Australian Railroad Group - which comprises the South Australian and Western Australian rail freight businesses acquired in December 2000 – were above budget. Retrenchment payments made or provided for in respect of announced employee number reductions resulted in below budget earnings in the period. The outlook for Australian Railroad Group is positive, with the second half boosted by the prospect of stronger than expected grain harvests in South Australia and Western Australia.

The divestment of Wesfarmers Transport's freight services and logistics operations was completed in December 2001 which, together with the June 2001 disposal of the Niteroad Express business, represented the major component of the rationalisation of the group's road transport interests. The remaining road transport operations have now also been disposed of with the exception of the North Queensland based Johnstone River Transport business. Profits from the divestments led to above budget road transport earnings in the period.

Gresham Partners, the company's partly owned investment house associate, performed strongly during the first half.

Finance

The group's ratio of net debt to equity as at 31 December 2001 was 54.9 per cent, down from 84.3 per cent at 31 December 2000. The rolling 12 month cash interest cover was 11.3 times, well above the group's minimum benchmark of four times and unchanged from last year.

Net operating cash flows in the period were adversely impacted by several one-off factors. The most significant of these was a marked increase in working capital in the hardware operations as a result of integration related re-merchandising programmes. Higher taxation payments were also made in the period as a result of changes to the corporate taxation instalment payment regime and the additional taxation payments attributable to the newly acquired Howard Smith entities.

Interim dividend

A fully franked interim dividend of 34 cents per share (last year 27 cents per share) payable to shareholders on 28 March 2002 has been declared by the directors and the company expects to maintain its dividend policy of paying out 100 per cent of profits, fully franked, for the full year.

The directors also decided that new shares issued under the company's Dividend Investment Plan in respect of the interim dividend will issue at a discount of 2.5 per cent to market, the same rate as applied last year.

Outlook

The directors are pleased with the half year result and are confident about both the prospects of the group generally and the immediate outlook for the second half of the financial year. Integration work on recent major acquisitions is proceeding well and the key businesses of the Wesfarmers group continue to perform strongly.

In the bidder's statement dated 13 June 2001 issued for the Howard Smith takeover, directors forecast Wesfarmers' operating profit after tax for the 2001/2002 financial year at $379 million, based on the assumption that the acquisition occurred on 1 July 2001 and that a full year of synergy benefits was received. Despite the fact that some of the synergy benefits will only occur over part of this financial year and that the acquisition was effected on 1 August 2001, the directors currently expect the group's full year result to exceed the $379 million forecast. This improved outlook arises from better than anticipated performance from all businesses and higher than expected synergies from the Howard Smith acquisition.

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ATTACHMENT TO WESFARMERS' 12 FEBRUARY 2002 NEWS RELEASE

PROGRESS REPORT ON THE INTEGRATION OF BUNNINGS AND BBC HARDWARE BUSINESSES

Good progress has been made in the integration into Bunnings of the BBC Hardware businesses – Hardwarehouse, BBC and Benchmark – following their acquisition, in August 2001, as part of the Howard Smith takeover. An overview of significant integration achievements is set out hereunder.

Management structure

Management of the BBC Hardware business was fully aligned with Bunnings' operational and administrative structure by the end of October 2001. Over 150 duplicated management and corporate office roles within BBC Hardware were made redundant.

To meet the demands of the expanded business, Bunnings increased its executive team with the introduction of the new role of Deputy Managing Director. Mr Peter Davis, formerly Bunnings' General Manager, Eastern Region, was promoted to this position in November 2001.

Store team training and development

Training in Bunnings' in-store methodologies and leadership approach has been provided to all Hardwarehouse and BBC store management personnel.

Bunnings' induction training has also been undertaken by over 7,000 Hardwarehouse and BBC store team members.

Branding and advertising

To maximise advertising synergies, a "one brand per region" re-branding programme for warehouse stores was completed by November 2001 and all Hardwarehouse stores except those in metropolitan Sydney, Tasmania, Toowoomba, Townsville and New Zealand were re-branded as Bunnings Warehouse stores.

In the regions where the Hardwarehouse name is still being used, advertising and in-store promotional material has been aligned to Bunnings' standards. This move will facilitate the planned re-branding of all Australian stores to either Bunnings Warehouse or Bunnings by the end of 2002. Branding in New Zealand will remain unchanged in the near term.

Suppliers and supply chain logistics

Substantial progress has been made in renegotiating terms with the large number of suppliers servicing the merged Bunnings and BBC Hardware businesses.

Contracts relating to BBC Hardware's former out-sourced distribution services have been terminated and a new distribution centre is being established in Smithfield, Sydney to complement Bunnings' three existing distribution centres in Brisbane, Melbourne and Perth. The introduction of Bunnings' supply chain methodology across the merged business is already delivering cost savings and these are expected to increase in the future from a focus on efficiencies and improvements across the expanded store network.

Store support functions and financial management

A detailed financial and commercial evaluation of BBC Hardware was undertaken following the completion of the takeover. This work resulted in a number of asset write-downs and accounting adjustments for obsolete inventory, bad debts and redundant store fixtures, fittings, plant and equipment. Provisions have also been established to reflect planned store closures. These adjustments were all taken to account as a pre-acquisition cost.

All key administrative functions for BBC Hardware have been integrated into Bunnings and the business has operated against revised operational budgets prepared by Bunnings management from October 2001. Significant savings in office accommodation costs will be delivered as lease commitments expire over the next two years.

Systems

Following a technical review, preparatory work to enable the shut-down of BBC Hardware's Australian back-office information systems for purchasing, pricing, stock, personnel and financial management is well advanced. By the end of March 2002, the merged Australian businesses will operate from Bunnings' core systems. As part of this work, the existing BBC Hardware point of sale systems will be

Significant savings will accrue from the operation of one system and the winding down of BBC Hardware's expensive SAP system.

New Zealand

An evaluation of the Hardwarehouse and Benchmark operations in New Zealand will soon be completed. An investment programme to expand the number of larger format stores and to rejuvenate the Benchmark chain is being developed.

Non-core operations

BBC Hardware operated nine frame and truss plant operations in New South Wales and Queensland. Four have good trading results, two have been closed and three are under review.

BBC Hardware also owned two small building industry related businesses – Cairns Roofing and Maitland Plaster. Maitland Plaster has been sold and Cairns Roofing has been closed.

Synergies

Despite delays in implementing the synergy benefits during this financial year, the overall aggregate benefit this year is expected to be close to the $40 million forecast full year benefit described in the bidder's statement dated 13 June 2001 issued for the Howard Smith takeover. Synergy benefits of at least $60 million per annum should be achieved in subsequent years.

Growth / store network development

Bunnings has historically achieved strong year-on-year revenue and earnings growth from its focus as a specialist retailer of home and garden products to DIY consumers. Growth has been delivered by increasing market share through existing stores and from opening new stores. Bunnings' focus on DIY consumers has resulted in significantly higher revenue and earnings relative to competitors. By way of example, average turnover in Melbourne metropolitan Bunnings Warehouse stores in the 2001 financial year exceeded average turnover in Sydney metropolitan Hardwarehouse stores by over 60 per cent.

Addressing the underperformance of BBC Hardware in DIY retailing is a significant growth opportunity for the merged business. Over the next three to five years, Bunnings expects to achieve growth through the application of its retailing approach and disciplines to the acquired Hardwarehouse, BBC and Benchmark stores. This process will involve a programme of refurbishment work over a two to three year period to restructure the physical appearance, layout and merchandising on a store by store basis.

At the same time, Bunnings will continue to concentrate on achieving real store on store growth from the existing store network and on developing new stores to service new markets. Over the longer term, development of about 10 to 12 new stores per annum is expected to continue.

Separate strategies to lift revenue and earnings by strengthening the business' position as a leading supplier of building materials to the housing industry are well advanced and will be gradually implemented over the next three years.

The closure of non-profitable stores and the replacement of stores that do not trade at Bunnings' benchmark levels will also enhance earnings. This aspect of the store network development work is likely to take place over a five year period and involve around 50 sites, including up to 10 warehouse sites. To date, two Hardwarehouse stores and eight BBC stores have been closed as part of this work.

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